T T Mboweni: G-20 seminar on economic growth

Remarks by Mr T T Mboweni, Governor of the South African Reserve Bank, at the cocktail reception for delegates to the G-20 seminar, Pretoria, 3 August 2005.

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Ministers, deputy ministers, governor, deputy governors and esteemed delegates

Let me extend a warm welcome to the delegates from the G-20 countries to the G-20 Seminar on Economic Growth, which is jointly hosted by the South African Reserve Bank, the People's Bank of China and Banco de Mexico. It is indeed an honour for me to welcome representatives from various leading countries for discussions on a topic that is of great importance not only to the members of the G-20 but to every country.

Permit me also to briefly remind you of the important principles that are set out in the G-20 Accord for Sustained Growth that was discussed at the sixth meeting of Finance Ministers and Central Bank Governors of the G-20 held in Berlin in November 2004.

Our Accord for Sustained Growth is all about mobilising economic forces for satisfactory long-term growth by focusing domestic policy on three tasks in particular: establishing and maintaining monetary and financial stability; enhancing domestic and international competition; and empowering people to participate. While appropriate and credible policies are the basis for economic growth, they need to be backed by high-quality institutions, including ethical standards in corporate governance. However, given the diversity of institutional settings and the success of different economic strategies among G-20 countries, it is acknowledged that there is no single template for strong long-term growth. Policies need to be shaped to the special circumstances in individual countries.

The Accord deems price stability as being indispensable for sustainable economic growth as it fosters investment and saving. High inflation is destabilising and has a strong negative impact on the poor, while deflation squeezes profits, discourages investment and leads people to postpone spending. The Accord acknowledges the importance of central bank independence in helping to achieve the goal of price stability in the long run. Fiscal discipline is seen to be equally important by, and fiscal policy should ensure that public expenditures and debt remain at reasonable levels in relation to national aggregates in order to prevent economic growth being restrained by crowding-out, anticipated future tax increases and inflationary pressures.

The Accord states that the domestic financial sector must be able to withstand economic shocks without giving rise to systemic problems which impair the allocation of savings to investment opportunities and the processing of payments in the economy. Currency mismatches could be diminished by strengthening domestic banking systems and capital markets. Strong domestic financial sectors can reduce the need for foreign currency borrowing and become an alternative channel of external funding by attracting foreign investors into domestic currency instruments. High priority must be given to implementing the relevant internationally recognised standards and codes.

The liberalisation of the capital account yields essential efficiencies and benefits for economic growth but the Accord stresses that the elimination of restrictions on capital movements should be appropriately sequenced and that countries seeking domestic monetary autonomy while substantially liberalising their capital account should increase the degree of exchange rate flexibility accordingly.

The Accord regards competition as the driving force of economic growth because it fosters efficiency and is essential for innovation and strong investment activity. Carefully designed policies of deregulation, privatisation, and liberalisation of international transactions are important means of strengthening competition. Policymakers are encouraged to aim at strengthening and enforcing intellectual and other property rights, contract law, bankruptcy procedures and anti-trust regulations. Also, efforts will be required to promote good governance and combat corruption.

Global trade liberalisation is deemed an essential instrument to promote growth by channelling resources to their most productive use. Policymakers worldwide are encouraged to move ahead vigorously on the basis of multilateral commitments giving due consideration to adjustment costs. Multilaterally consistent bilateral and regional agreements can also contribute to trade liberalisation.

Labour market conditions are also crucial cornerstones in achieving high employment levels and broad participation of the labour force and both wage levels and working hours need to be responsive to market requirements and reflect national circumstances. The Accord also emphasises the importance of policies to provide opportunities and incentives to gain and improve skills, foster labour mobility, strengthen incentives to work in the formal sector and reduce information asymmetries. A favourable overall investment climate, including adequate infrastructure, will support domestic capital accumulation and also be attractive for foreign direct investment.

The Accord states clearly that mobilising all productive forces of a society requires empowering individuals and enhancing economic participation. Education and training are key requirements as they improve people's chances of finding jobs and contribute to higher productivity. The broadly-based provision of high-quality education should be a responsibility of governments. An educated population is better placed to demand the provision of good governance and sound institutions. Broadly-based access to a wide range of financial services and reducing impediments to small businesses, such as the time to start a business, is of crucial importance as it fosters entrepreneurial capacities and facilitates the integration of people into the formal economy. While employment is the first and best safeguard against social exclusion, social safety-nets are needed to cushion the effects of unemployment. Moreover, the elements of social infrastructures such as clean water, sanitation and basic health services are public goods whose provision has a positive impact on welfare and potential growth. It is important to design social policies so as to permit market mechanisms to function effectively.

As to the agreed actions to implement the G-20 Accord for Sustained Growth, the Finance Ministers and Central Bank Governors adopted the reform agenda that translates our G-20 Accord for Sustained Growth into concrete policy measures for our countries. Progress in this regard will be reviewed at the meeting in Beijing in October 2005, which this seminar will feed into.

As to progress by South Africa, I am particularly pleased to report that the Reserve Bank has been making an important contribution to macroeconomic stability, thereby creating a stable framework for growth. CPIX inflation has remained in the 3-to-6-per-cent target range since September 2003, i.e. for 22 successive months. Gross domestic product growth measured 3,7 per cent in 2004 and is expected to grow at similar levels this year, and the government's objective is to implement policies to raise the growth rate to even higher levels. To promote growth and employment, the South African government has continued along the path of fiscal discipline and has been focusing on enhancing the efficiency of the public service and on infrastructure investment, increasing savings and skills development. The deliberations of the next two days will help shape the strategies in this regard.

I wish to conclude by referring to the often quoted inspirational words from Robert Lucas in 1988 " Is there some action a government of India could take that would lead the Indian economy to grow like Indonesia's or Egypt's? If so, what exactly? If not, what is it about the "nature of India" that makes it so? The consequences for human welfare involved in questions like these are simply staggering: Once one starts to think about them it is hard to think about anything else."[1] Clearly the Indian government seems to have met Lucas's challenge and so there are surely lessons to be learned from each and every country's experience. We look forward to the presentations by the various delegates as set out in the programme during the course of the next two days and to discussions on economic growth and issues of common interest and relevance to our various countries. Meanwhile, welcome once again and may this important seminar achieve all its objectives.

Thank you.

Zhou Xiaochuan: Improve corporate governance and develop capital market

Speech by Mr Zhou Xiaochuan, Governor of the People's Bank of China, at the High-level Forum on China's Reform, Beijing, 13 July 2005.

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Dear friends, ladies and gentlemen,

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[1] Lucas, Robert E., Jr. (1988). "On the Mechanics of Economic Development." Journal of Monetary Economics, 22, July, 3-42.

Good morning. It's my pleasure to attend this High-level Forum on China's Reform.

The theme of this forum, which is "Promoting Institutional Innovation by Emphasizing the Reform of Government Administration System", implies that discussions will be made on the performance of the government and the steps it needs to take in the future. Having a well-established tradition of criticism and self-criticism, the Chinese government has always attached importance to promoting the reforms by deepening its understanding of various issues. In this context, I would like to speak on the roles of the government in promoting the reform of the financial institutions.

First, the government needs to further clarify the objectives of the reform and restructuring of the financial institutions. Why should we spend resources on financial sector reform and restructuring? There are two answers to this question. Some people think that financial sector reform aims at preventing risks, crisis and instability, thereby avoiding causing trouble on the government. People holding such a view believe that since risks are concentrated in the financial sector, some risky financial institutions should be closed to eliminate the risks. While some people think that the sustainable, steady and healthy development of the national economy depends on a robust financial sector that provides good financial services. Therefore, we need to carry out the reforms to make most financial institutions strong and healthy, so that they will be able to operate with lower risks and at the same time provide good services, thus contributing to the development of the national economy.

The first view is somewhat narrow and short-term based. Risk is not the only factor we need to consider. Inadequate financial services will hamper economic development. One example is related to the rural financial institutions. After we closed some financial institutions because of their unhealthy development, financial services in the rural area became insufficient, hindering the development of the rural economy. The second view emphasizes the role of the financial sector in the allocation of resources. With inadequate financial services, the savings will not be effectively allocated, resulting in a waste of resources and significant negative impact on the long-term growth efficiency. Although the financial sector will give rise to risks, it can also absorb risks. In fact, the financial sector absorbs some of the risks produced by the real sector, and plays the role of price-discovery for the real economy. If performing well, the financial market can serve to absorb, buffer and resolve risks.

If we hold the view that the objective of financial sector reform is to make the financial institutions stronger and healthier, measures need to be taken in many areas. First, the government should properly handle the burden of non-performing assets of the financial institutions left over from the past or during the transition period. Second, sound financial, accounting, loss provisioning and tax systems need to be set up to create a favorable institutional environment to enable the financial institutions to develop soundly and provide good financial services. Third, the government should remove unwarranted controls and establish effective incentives to encourage the financial institutions to improve their services and contribute to better allocation of resources. Fourth, steps need to be taken to promote competition-based market mechanisms and eliminate unnecessary price control to enable prices to play a larger role in the economy. Fifth, measures should be taken to help the financial institutions to improve their ability to properly set the prices, including on the money market and capital market. Sixth, we also need to take active and steady steps to develop various instruments including the financial derivatives that can help form an effective pricing mechanism in the market. Seventh, clear strategies on the intermediate services, including accounting, evaluation and credit rating, need to be formulated taking into account both the current need and long tem development of the market.

Second, principles and guidelines of corporate governance need to be further clarified. Many people have realized that improving corporate governance is of crucial importance to the entire reform. Nevertheless, the concept and content of corporate governance have yet to be clarified.

The basic requirements of corporate governance are set in the Company Law, which needs further improvement in China. On the other hand, the Company Law does not encompass every aspect of corporate governance. Corporate governance involves the agreements or practices outside the stipulations of laws and regulations and those of the self-disciplinary organizations as well as the cultural traditions. In China, different departments or institutions have different understanding for the requirements of corporate governance. We can see that these requirements have major omissions, and no guidelines have been given to resolve the main practical issues. No official view has been clearly expressed regarding the OECD Principles of Corporate Governance (both the 1999 version and the 2004 revised version). Therefore, the reform of corporate governance is likely to be a reform without clear definitions. I'm going to give several examples in this regard. First, preserving shareholders' rights is one of the core elements of corporate governance. Nevertheless, violating the rights of the shareholders is not a rare phenomenon in China, and there is explicit solution to this problem. For instance, in the debt-equity-swaps, no effective measures are in place to safeguard the rights and interests of the shareholders, and in many cases, the assets they were holding turned out to be neither a loan nor an equity. Second, the OECD Principles of Corporate Governance emphasizes the role of stakeholders. So far, there has not been an accurate and widely accepted translation in Chinese for the word "stakeholder", nor do we have principles or guidelines concerning the role of stakeholders in corporate governance. Third, the respective roles of the Party organizations and of the board of directors and the management need to be clarified. This is an issue unique in China. In most cases, the Party organizations play a positive role in supporting the operation of the board of directors and the management. However, there are some occasions where the Party organizations and the board of directors or management hold different opinions on certain issues, calling for principles and guidelines to resolve such issues. Fourth, the relationship between corporate governance and the authority's regulation and supervision need to be properly handled. In the planned economy and during the early transition period, government acted as both the owner and the supervisory authority of the enterprises. Despite the fact that enterprise management and government supervision have been basically separated, there are often cases where these two become mixed together. Clear principles and guidelines are needed in this area.

Improving corporate governance is a reform on which the public has placed great hopes. We must not let the public disappointed because of unclear principles and guidelines in pursuing the reform. The government should play an important role in setting up clear principles and guidelines on corporate governance by drawing upon the international and historical experiences as well as taking into account China's current specific situation.

Third, the operations and policies of asset management companies need to be improved. During the several years of development since they were established in 1999, some problems have emerged, which are reflected in the prices at which the non-performing assets are disposed, the abuse of power for personal gains, and the undue transfer of benefits. Several issues are yet to be clarified. First, if and only if the objective of the reforms is to make the financial institutions stronger so that they can provide better financial services does it make sense to dispose the non-performing assets left over from the past, particularly during the period when the management of the enterprises were not separated from government administration. Otherwise the disposal of non-performing assets would be nothing but transferring the risks from the "left pocket" to the "right pocket" of the government, which will invite criticism from the public. Second, the asset management companies have been established to handle the non-performing assets in a professional way. It should be noted that the assets they are dealing with are not good assets, but those classified as doubtful or loss. In terms of value preservation and enhancement, different methods are required for handling the non-performing assets and the good assets. When seeking to recover the bad assets, we need to strike a proper balance between quantity and speed. Although the value of some assets will go up after they have been held for a considerable period of time, in most cases, the longer the assets have been held, the less their value will become. In this sense, the so-called "ice cream effect" does exist. On the other hand, the asset management companies seeking to dispose the non-performing assets very rapidly will likely face criticism, since people think that more will be recovered if the assets are disposed less rapidly. Third, against the background of market-oriented reform, the disposal of non-performing assets will be done through the market. Therefore, measures should be taken to develop the market and enable the assets to be disposed at the prices formed through market competition. This requires that market participants be under hard budget constraints, having sound financial system, clearly defined ownership and well established incentive structure. Regarding incentives, the government should set a clear baseline for the recovery of the non-performing assets, and establish an effective incentives system that will encourage the asset management companies to make the greatest efforts in recovering the assets. Problems will occur in the market-based disposal of non-performing assets if any of the above-mentioned measures are not taken properly.

What can the government do? First, steps should be taken to improve the legal framework. Although we have in place a regulation on asset management companies, there are weaknesses in the formulation, administration and enforcement of laws and regulations governing the disposal of non-performing assets. International comparison shows that China needs to make improvement in this area. Second, apart from the four state-owned asset management companies, private and foreign participants should be encouraged to enter this market to promote competition. Third, internal reforms should be carried out in the four state-owned asset management companies to enable them to operate on real commercial basis with hard budget constraints. Fourth, when the market has not been fully developed, it is desirable to let the institutions with rich market experiences to make price evaluation so as to avoid soft constraints and set up internal incentives. Fifth, efforts should be made to establish proper incentives. Without incentives or with very weak incentives, it is not possible to preserve and enhance the value of the assets and make maximum recovery. Without effective incentives, people may also tend to seek personal gains from the disposal of assets. Sixth, it is important to have appropriate procedures and prevent any improper practices so that the assets are disposed through market competition. However, if the market is not strong enough – for example, market participants are under soft constraints or there are adverse internal incentives, improper behaviors may arise even with sound procedures, and the procedures themselves may become a shelter disguising those improper activities. Seventh, it is crucial to develop market intermediaries, since the disposal of assets relies importantly on the integrity and services of the intermediaries. Eighth, the objectives of setting up asset management companies are not only to dispose the non-performing assets in a professional way, but also to make the commercial banks stronger so that they will be able to provide better financial services. So the government needs to consider how to handle the relationship between the asset management companies and the commercial banks.

The asset management companies will not operate satisfactorily and there will be much criticism from the public if the above are not handled properly.

The State Council attaches great importance to the issues concerning the asset management companies. Premier Wen Jiabao has said that “the asset management companies have had five years’ experiences in disposing the non-performing assets, and it is time for them to carefully review the experiences and lessons and try to resolve the long-term problems”. Apart from promoting more effective internal management of the asset management companies and strengthening external regulation and supervision on them, the government has much more to do. From the longer-term point of view, China will need a well-functioning capital market to enable its economy to develop soundly.